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**ELEMENTS OF INDIAN
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TORONTO

ELEMENTS OF INDIAN TAXATION

ELEMENTS OF THE THEORY OF TAXATION

WITH SPECIAL REFERENCE TO

INDIAN CONDITIONS

BY

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PREFACE

THIS little book owes its appearance to the somewhat accidental circumstance that during the last few years special causes have compelled me to read a good deal of controversial literature, mostly of a journalistic kind, dealing with Indian administrative matters, and apparently widely read by the educated public of India. This literature I have found full of criticisms, often very pungently and eloquently expressed, of the methods of taxation adopted by the Government of India. But nearly the whole of it is characterised by a strange lack of perspective. Speakers and writers seldom see Indian financial conditions steadily, or see them whole. They content themselves with attacks on isolated parts of

the tax-system, without clearly realising that it is impossible to criticise the parts satisfactorily, except in relation to the system considered as a unity. Thus their well-meant efforts appear both to administrators and to political economists almost invariably misdirected, and their work has borne little fruit.

The British Government, both in the United Kingdom and in India, has accepted very unreservedly the principle of taking the public into partnership in all matters affecting taxation and general administration, and, compared with most European Governments, is peculiarly responsive to reasonable criticisms. Few readers of the political literature above referred to seem aware of the existence of the vast masses of statistical information, official reports of governmental departments and royal commissions, and so forth, which are perpetually being poured forth by the labours of the permanent civil service. These official publications (parlia-

mentary papers and "blue books") are specially intended to supply information that will assist Cabinet and Parliament in the work of legislation and at the same time enable the intelligent sections of the public to criticise effectually the activities of the State. They form the raw material on which both statesmen and economists must work in order to work to any purpose. Many of them relate to conditions in India and are procurable at very low prices; as the Government is always desirous of having its work subjected to as much fair-minded, intelligent criticism as is available. Among those publications most suitable to enable the ordinary reader to check the sort of information contained in this volume are the following :

Statistical Abstract relating to British India (Annual; price, about 1s. 3*d.*).

Statement exhibiting the Moral and Material Progress and Condition of India (Annual; price, about 1s. 2*d.*).

Memorandum on some of the results of Indian Administration during the past fifty years [Cd. 4956] (Price 3½*d.*).

Of these, the first is composed of masses of figures and is intended to be used as a work of reference. The other two are straightforward, simply written reports, dealing with such matters as Legislation, Justice and Police, Finance, Manufactures and Trade, Progress of Education and Literature, Migration and Emigration, changes in prices, wages, etc.

For comparative purposes the following will be found useful :

Statistical Abstract for the United Kingdom (Annual ; about 1*s.* 8*d.*).

Statistical abstract for the British Colonies, Possessions and Protectorates (Annual ; about 1*s.* 11*d.*).

Statistical Abstract for Foreign Countries (Annual ; about 1*s.* 6*d.*).

To these may be added the following

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official publications dealing with points of theory :

Fiscal Policy of International Trade [321].
(Price 3*d.*).

Memoranda chiefly relating to the Classification and Incidence of Imperial and Local Taxes [C—9528] (Price 2*s.*).

My thanks are due to Mr. J. M. Keynes for much assistance with the proofs and for numerous suggestions ; and also to Mr. H. J. Wolstenholme for similar kindnesses. The responsibility, however, for any errors that may remain rests entirely with myself.

FITZWILLIAM HALL, CAMBRIDGE,

October, 1910.

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ELEMENTS OF INDIAN TAXATION

CHAPTER I

GENERAL PRINCIPLES

§ 1. THE ordinary individual, aiming at the most satisfactory arrangement of his life on its economic side, endeavours to make his total income (received either in money, or in goods and services) as large as possible, and then, in some way or other, adjusts his expenditure to this income. A group of men associated together for some common purpose, such as the maintenance of a football club or the control of any corporate economic enterprise (*e.g.* a railway or banking company), usually approaches the problem of income and expenditure from a different standpoint. Its members begin by deciding how large a sum

it is advisable for them to expend on club requirements or to invest in promoting their commercial venture, and then proceed to obtain this amount for group-purposes by demanding a contribution from each of the group-members. The joint revenue of the group is adjusted as accurately as possible to the group-expenditure, and careful calculations are usually made in order to keep this joint revenue within the lowest limits consistent with the possibility of achieving satisfactorily the objects for which the society was constituted.

What holds good of the voluntary group holds good equally of the larger communities of which we are all more or less involuntary members—the municipality or other administrative division, and the State. A large public revenue is no direct criterion of the wealth of a State. If a Government habitually receives a revenue greatly in excess of its expenditure, if it has, that is to say, recurrent “surpluses,” this fact is less a sign of growing wealth than of a badly adjusted financial system, unless, of course, the surpluses are deliberately “budgetted” for, with the object of reducing

existing indebtedness. In other words, a Government has no business to be "well-off," in the sense in which individuals are described as "well-off" when they regularly receive more than they are in the habit of spending. A good business man makes his income as large as he can. A good Government makes its revenue as small as it safely can.

A Government should aim first at determining as accurately as it is able the total sum that it will need to spend in the course of, say, a year, by putting together the amounts that it considers reasonably demanded by the various requirements of defence, education, repayment of past indebtedness, and so forth; next it calculates what the existing taxes are likely to bring in during the course of the year; and then introduces such changes in the system of taxation as will be necessary in order to make the aggregate revenue balance the aggregate expenditure. This is called "drawing up the Budget." It involves, firstly, an attempt to forecast what the Government will probably receive and probably expend if it goes forward with its administrative work without change of system; and, secondly, a

deliberate decision as to whether any changes of policy are advisable either as regards the amount or direction of its expenditure or as regards the amount or the sources of the revenue.)

It is not intended by these statements to imply that a Government can draw up the expenditure side of its balance-sheet without taking into account national resources or those national habits which permit a certain scale of taxation to be considered by the popular mind as reasonable simply because it is customary. Heavily increased expenditure on Education (for instance) and on the Police Service may at the present moment be much more desirable in India than in England; but the Indian Government, having to consider ways and means with anxious care, is compelled to postpone reforms the cost of which would impose burdens likely to arouse bitter feelings of resentment in the mass of the taxpayers. *Thus a mere agreement that a particular form of public expenditure would yield fruitful results of the highest importance is not by itself a conclusive reason for imposing the new taxes that it would necessitate.*)

Some branches of expenditure, however, such as national defence, have their amounts determined by circumstances which a Government cannot seriously modify. Thus the Government of the United Kingdom finds itself compelled to spend about 60 millions, of the annual total of 120 millions that it would otherwise have at its disposal, on the requirements of the army and navy; and beside this 60 millions must be set the greater part of the annual interest charge involved by its huge national debt (750 millions), the bulk of which has been incurred in connexion with previous military operations. Similarly the Indian Empire (in spite of the fact that the chief part of its defence is sustained by the British navy free of charge¹) finds itself compelled to spend on Defence purposes nearly 20 millions out of a total of 47 millions of net revenue (though it has no debt burden

¹ India bears the cost of the upkeep of Aden, which may perhaps be classed as naval expenditure, the importance of Aden being mainly strategic. The "marine" charges included under the heading of Defence amount to less than half a million and are incurred for the upkeep of war-ships that serve purposes partaking chiefly of the nature of police functions.

of a military character comparable to that of England).¹

§ 2. Having determined, after weighing a multitude of social and political considerations, what aggregate amount it proposes to expend, the Government must ask itself how it can raise this amount most economically and most equitably.

“Economy” in taxation has more than one significance. Some forms of taxes are seen to be too costly to collect, when the total yield of the tax is compared with the expense that the Government is put to in preventing evasion. (We may take as an instance a customs duty on an article of which little is

¹ The above comparison is given as illustrative of the difficulties to be met by the two Governments, not of the relative military burdens borne by the two peoples. If all account of their respective war debts be omitted, the military burden per head in the United Kingdom is about £1½, in India about 1½ rupees. It would be interesting if we could supply a similar comparison for Japan. But in that country a large part of the military burden consists in compulsory military service, which does not appear in an ordinary financial statement. The military burden per head (apart from this) amounts to Rs. 3. There is also a public debt (due largely to military needs), between five and six times the Ordinary Debt (see p. 94, *infra*) of India, borrowed at much higher rates, the interest charges of which are borne by a population one-fifth as numerous as that of British India.

imported and that little is easily smuggled owing to smallness of bulk.) Other taxes may not be costly to collect, but may give rise to political discontent of a kind that increases the difficulties of the Government, and by necessitating greater expenditure on the services connected with justice and police, involves increase of taxation in general. Other taxes again may be free from these faults, but may incidentally benefit some industries at the expense of others (the usual effect of all customs duties even when such evil consequences are carefully guarded against); and if the loss to the injured trades be greater than the gain to the protected trades there has been a total reduction of the wealth of the country apart from the cost of collection,) and incidentally therefore there will be an increase in the difficulty of obtaining the necessary revenue. All taxation producing effects of this kind may be classed as uneconomical.

It must be remembered, however, that every possible form of tax involves *some* cost, if only in the way of payments to the staff of clerks appointed to receive, and render accounts of, the amounts collected, and also in

the way of notifications to taxpayers of the amount required and investigations to prevent evasions of the payment. Every tax, moreover, must involve losses to the community of an indirect character. The State cannot hope to be able to impose taxes which will be perfectly free from all these forms of incidental loss. Successive Indian Governments, for instance, have never been able to dispense with Land Taxes as the central feature of the system by which the expenses of the State are to be met. Yet, even as at present organised, the system involves a costly re-assessment of the land and its produce at periodical intervals¹; during the assessment agricultural operations are to some extent disorganised) and hostile critics declare that uncertainty as regards future valuations prevents cultivators in many cases from introducing improvements which might involve future increases in assessment. These, no doubt, form serious drawbacks to the system, though with improving administrative methods and increasing experience on the part

¹ The administrative charges in collecting a Land revenue of nearly twenty million pounds amount to about three and a half millions.

of the State, they are becoming of less and less account. But just as the mere agreement that certain forms of public expenditure are likely to yield the most fruitful results is not by itself a conclusive reason for imposing additional taxes, so, also, *the mere agreement that a certain element in the tax system has highly undesirable features is not by itself a conclusive reason for dispensing with it*; for under any system of taxation it is impossible to eliminate *all* drawbacks.)

§ 3. Before one can attempt to judge whether any particular tax is equitable or not, it is necessary to examine it, not in isolation but in conjunction with the rest of the system of which it forms a part. For a reasonably equitable tax system may be drawn up consisting of a number of different taxes, each of which, when considered separately, is obviously unjust (one tax falling heavily on the village peasant, another on the town artisan, a third being paid by another class, and so on); yet when all are taken together the injustices may so counterbalance one another that the system as a whole is not conspicuously unjust. A complete system of taxation can with advan-

tage be subjected to scrutiny as conforming or not conforming to principles of equity. It is seldom that the same scrutiny can be applied to any single item of a system (such, for instance, as the Salt tax in India); one must know the purpose for which it is imposed and the part it plays in the general scheme of taxation before one can pronounce judgment.

§ 4. But there are also fundamental questions with regard to the meaning of Equity which must be faced before the equitableness of any Government's budgets can be discussed.

It is almost necessary for the purpose of financial discussion to postulate, in the first place, that the existing distribution of wealth between class and class within the nation is to be taken as equitable. This postulate is made merely for simplicity's sake. It is necessary with a view to clearness of reasoning that we should handle one problem at a time. And if we begin by asserting that the existing state of things with regard to wealth and poverty is fundamentally bad, and assert that equity requires that the State should endeavour to combat the evils of it by imposing taxes which will reduce the inequalities of rich and poor,

we shall find ourselves embarked on a course of argument which, though profitable in some ways, is likely to prove interminable. For simplicity's sake we must accept for the present the existing order of society as something *given*, and leave the question of the remedying of its ills as being, for our purposes, at least temporarily irrelevant.

§ 5. Seeing that all benefit, directly or indirectly, by the governmental activities which are paid for by the taxes the Government levies, it seems right that all should contribute towards the revenue in some degree. But if A's wealth may be estimated at Rs. 100, and B's at Rs. 1,000, ought B to pay just ten times as much as A, or ought he to pay more than ten times? In this question there is involved a conflict of two principles—the Proportional principle and the Progressive—and the point at issue is rather a psychological than an economic one. We have to decide whether a sacrifice of Rs. 10 on the part of B is equal to, or less than, a sacrifice of one rupee on the part of A. To this question, in my opinion, no perfectly conclusive answer can be given. The

preponderance of opinion is perhaps in favour of Proportionality. (The belief in the justice of the Progressive principle is, however, widely held; though in most popular discussions of the subject the psychological argument will be found combined, in a rather confusing way, with the "Socialistic" argument (touched on in the previous paragraph) that the State should aim at reducing existing inequalities of wealth.

§ 6. But whether we accept the Proportional or the Progressive principle we have still to ask how a man's wealth is to be measured. If X is a merchant whose total property could be sold for Rs. 10,000, and whose income is Rs. 2,000 a year; while Y is a lawyer whose property is worth Rs. 1,000 and whose income is Rs. 1,000; ought X to be considered ten times as rich as Y, or only twice as rich? In other words, shall we measure a man's wealth as a *stock* (asking how much property he would leave if his death occurred now) or as a *flow* (asking how much wealth he is receiving each year)? Shall we take a man's *income* or his property as the true gauge of the extent of the sacrifices that we demand from him? And

further we may ask—what constitutes his income precisely? Is it the amount that he receives and is free to enjoy as he pleases by spending it on necessities, comforts and luxuries? Or is it the amount which he actually does so enjoy?) Shall we, that is, in order to arrive at an equitable basis for estimating a man's taxable income, subtract what he saves from the total that he receives, and accept his annual *expenditure* as the true gauge of his wealth? (We may adopt the latter alternative either on abstract considerations—because, until spent, what a man saves is potential rather than actual income; or on the ground of social expediency—because savings, provided they are invested in productive undertakings and not hoarded, benefit the community in ways that income which is directly enjoyed does not.)

§ 7. These are all delicate and difficult questions of theory, but they will be found at every turn to have serious bearings of practical importance. On full consideration it would seem, on the whole, most nearly satisfactory of ideal demands to take Annual Expenditure as the best gauge of each man's wealth, modifying it, how-

ever, by some reference to the amount of Property that he possesses—Property of course being taken to include not merely concrete goods such as houses and lands, but also bank credits and stocks and bonds. But practical considerations make it simpler, as a rule, to take Income rather than Expenditure as our criterion. And this is what is attempted in that part of the English tax system which affects especially the middle and upper classes. Each income-tax-payer makes a statement of his total income and of the sources from which it is derived, and, except in the case of the smaller incomes, he is taxed more heavily on the part of his income that comes from Property (officially designated “Unearned Income”); while a small, unimportant concession is made in the direction of taxing Expenditure and exempting savings, by the exemption from taxation of any sums paid as Life Insurance premiums.)

§ 8. The reader must bear in mind that we are here discussing not the best *form* of tax—Income Tax, Property Tax, or Expenditure Tax—but the most equitable *test* of the total contribution which each individual should make to the national revenue. The question

as to what form of tax is most advisable—the choice of the special devices by which he may be made to contribute—is a different type of problem, being concerned with ordinary practical considerations of an administrative and political kind.

Thus, until very recently, the English tax-system has aimed, roughly, at obtaining from all taxpayers, rich and poor alike, a fairly equal proportion of their total incomes.) Gradually there has been introduced also the principle of taxing those who possess an appreciable amount of property more heavily than those who have little, first by the imposition and gradual increase of the Death Duties (taxes imposed on property received at the death of the previous owner), and then (within the last few years) by differentiation between the part of an income-tax-payer's income that is derived from Property and the part which results from personal exertion; while concessions are also being made in the direction of substituting the Progressive for the Proportional principle both in the case of the Death Duties and in that of the Income Tax. But no attempt is made to collect income-tax from the mass of the working classes)—all

those, namely, whose total incomes fall below £160 a year. This, however, is not intended as a concession to poverty. It is merely a recognition of the administrative difficulties in the way of collecting such a tax from ordinary working men. These difficulties are fairly obvious. Receiving his wage from week to week, and frequently out of employment for irregular periods, the working man is not likely to be able to give a correct statement of his annual earnings; even if he were able, it would be impossible, without an immense amount of costly investigation, to check his statements and compel the dishonest to pay as much as the honest workman; and even if these difficulties also were surmounted it would in practice be impossible to induce working men to lay aside systematically from week to week the necessary sums to meet the tax-gatherer's demands at the end of the year; and finally the collection of the tax would cause bitter political discontent and would necessitate a great deal of administrative and judicial expense before it could be enforced.

This being so, the English Government makes no attempt to collect a direct tax from

the working class. Instead, it taxes heavily certain commodities of almost universal consumption (alcohol, tobacco, sugar, coffee, cocoa, tea, and dried fruits), and thus obtains from the working class as a whole something like the same percentage of their estimated aggregate earnings that it obtains from the aggregate incomes of the income-tax-payers.) And as the amount thus indirectly contributed by the poorest of those who do pay income-tax is certain to constitute a larger proportion of their income than is the case with those who are still wealthier, a system of exemptions is introduced for the benefit of these lower incomes. Thus, if a man's total income falls below £400 he is entitled to subtract £160 from the total and pay income-tax only on the remainder. A man, therefore, whose income is £200 pays income-tax (say, 1s. on every £) on £40 only (40s.), and a man earning £300 pays on £140 (140s.). Similar smaller deductions are made on incomes between £400 and £700 (the theory being that what is paid as income-tax added to what is paid indirectly in commodity taxes will extract about the same percentage of each individual income.)

To take an imaginary arithmetical example. If a working man earning £100 a year contributes £5 a year through the taxes on the alcohol and tobacco that he buys, then a professional man receiving £300 ought to contribute £15. If the income-tax is levied at the rate of a shilling in the pound he pays (after the customary deduction of income is made) an income-tax of £7; and if he consumes rather more of the taxed commodities than the working man, so as to contribute £8 to the State by this form of tax, his total contribution will amount to the required £15. (This example illustrates what has been said above about the inequitableness of one part of a tax system considered by itself being counterbalanced by a different kind of inequitableness in another part. It is a very rough method of counterbalancing, but is clearly necessitated by the administrative difficulties which have just been discussed).

§ 9. A similar difficulty on a much larger scale immediately confronts us when we turn from a relatively rich country like England to a relatively poor country like India. In the United Kingdom there are roughly 1,000,000

people whose individual incomes exceed £160, and these with their families constitute between one-eighth and one-ninth of the total population.) The amounts contributed by these in direct taxes (Income Tax, Death Duties, and Inhabited House Duty) constitute about five-twelfths of the total tax revenue. But in British India the number of taxpayers on whom it has been found possible to impose any sort of income-tax is only about 250,000 out of a total population of nearly 250,000,000, a number constituting with their wives and families less than one-two-hundredth part of the total population.¹ While, therefore, the Income and Property taxes may be regarded as the backbone of the English system, an income-tax can in India form only a very subsidiary part of the financial system.

What then is to be substituted, if it is desired that the whole population, rich and poor alike, should contribute in proportion to their respective abilities to the expenses of

¹ The figures are not quite comparable, as agricultural incomes in India are exempt. The income-tax, however, is levied on non-agricultural incomes exceeding Rs. 1,000 (£66½) a year.

the Government? There is one and only one obvious answer. Sixty-five per cent of the population of India make their living in pursuits closely connected with agriculture. The central tax (or group of taxes) must therefore be some kind of Land Tax; and, corresponding to the English alcohol and tobacco taxes mentioned above, there must be some form of commodity tax that will fall upon those who for any reason do not contribute to these Land Taxes. The commodities chosen are cotton goods and salt.¹

¹ i "On all grounds of general principles, salt is a perfectly legitimate subject of taxation. It is impossible in any country to reach the masses of the population by direct taxes. If they are to contribute at all to the expenditure of the State, it must be through taxes levied upon some articles of universal consumption. If such taxes are fairly adjusted, a revenue can thus be raised, not only with less consciousness on the part of the people, but with less real hardship upon them than in any other way whatever. There is no other article in India answering this description upon which any tax is levied. It appears to be the only one which, at present, in that country can occupy the place which is held in our own financial system by the great articles of consumption from which a large part of the imperial revenue is derived. I am of opinion, therefore, that the salt tax in India must continue to be regarded as a legitimate and important branch of the public revenue. It is the duty, however, of the Government to see that such taxes are not so heavy as to bear unjustly on the poor by amounting to a very large percentage upon their necessary expenditure. The best test whether an indirect tax is open to this objec-

§ 10. We have begun our preliminary discussion by assuming that in raising taxes a Government is actuated only by the desire to obtain in the most equitable and economical manner the amount absolutely necessary for meeting the aggregate expenditure which it considers advisable.) Such an assumption, however, must, especially in an economically backward country like India, be of a somewhat unreal nature. A certain proportion of the total expenditure (that on Defence and general administration) is of an absolutely essential character. Other forms of expenditure, such as those concerned with Education and Irrigation, while not imperative in the same degree, have a special financial interest. For if the amounts raised by taxation for expenditure in these directions are wisely expended, it is to be expected that the ultimate effect will be to increase the productive power of the population and thus to render the collection of still greater public revenues for expenditure in the same manner continuously more

tion is to be found in its effect upon consumption." (From a despatch of the Duke of Argyll, as Secretary of State, to the Government of India, quoted in Sir John Strachey's *India*, 1903, p. 167.) See, however, p. 71, *infra*. 5880.

practicable. Such taxes form a sort of compulsory co-operative scheme the effects of which are cumulative from generation to generation. For this kind of public compulsory co-operation there is unusually large scope in India. But in connection with each specific proposal there is always the initial difficulty of enforcing the first small contributions that will set the large public-benefit schemes a-going. Each project demands money, and money can only be obtained by taxation; while human nature, all the world over, leads the taxpayer to resent every additional burden, however apparently trifling, and however likely to be socially beneficial. (Even if the original capital for starting a scheme of universal education could be raised by public loans, it would still be necessary to raise by taxes the amount required to pay the necessary interest. (This, however, is not equally true of great undertakings of a directly remunerative kind.) Though expenditure on public roads may be recovered only very gradually and indirectly through the growth of industry and trade, expenditure on State railways may almost immediately become

directly remunerative, and—as is usually the case in India—contribute ultimately to the public revenues an amount over and above what is required for the payment of interest sufficient to lighten appreciably the total burden of taxation.)

§ 11. A Government, however, may, in framing its budget, be influenced by other motives than that of raising easily and equitably a sufficient revenue to cover proposed expenditure. It may, as has been already suggested, aim at remedying what it believes to be economic injustices, and seek, by “Socialistic” taxation, to equalise the advantages of rich and poor. It may, for reasons of health or public morality, seek to divert consumption from one set of commodities to another, by placing heavy taxes, that would otherwise be needless, on commodities like opium and alcohol, or by supplying wholesome milk and pure water in the crowded quarters of cities at a price which involves a loss (and involves therefore the taxation of other classes for the benefit of the specially favoured class). It may, for numerous reasons, desire to divert productive activity from one industry to another. It

may, for instance, argue (as Protectionists argue in countries like England) that it is desirable that a nation should not become so predominantly urban as to be unable to produce its own food supply; or (as is frequently urged in countries like India and Australia) that it is desirable that every nation should have its industries as much diversified as possible; or it may believe that certain industries are in the long run likely, through the natural advantages possessed by the country, to become so much more prosperous than other industries that the surplus gains ultimately received by capital and labour in carrying them on will more than recoup all that has been expended in fostering them.

Thus we have at least four possible motives that may influence a Government that is considering the imposition of a particular tax. It may desire :

- (1) to exact from a certain class of citizens an equitable contribution as economically as possible;
- (2) to minimise disadvantages due to inequalities of wealth;

(3) to divert consumption from noxious to wholesome commodities ;

(4) to divert production from one set of commodities to another, for the sake of anticipated military, social, political, or purely economic advantages.))

Very frequently two or more of these objects are kept in view simultaneously ; and a tax which from the purely financial and administrative standpoint would appear somewhat unsatisfactory is retained for the sake of one or other of the alternative reasons above mentioned.

Of these four possible objects of a tax system, it is impossible here to discuss the second, as it would involve a thoroughgoing investigation of the whole economic system of society, as well as an attempt to pronounce on the righteousness or unrighteousness of the fundamental ideals of Socialism.

The fourth is largely bound up with the theory of International Trade and the relative advantages and disadvantages of Free Trade and Protection (for the usual, though not the only, method of achieving the proposed object

is by the imposition of Customs Duties). The controversies involved in this subject cannot wholly be ignored; but in a book of the present type they can be treated only very cursorily and rather superficially.

The third is of relatively small *theoretical* importance, though its bearing on social welfare may prove to be very great.

(The main business of a text-book of Public Finance is therefore with the first, the purely financial object of taxation.)

§ 12. We have referred briefly to the necessity of a good tax system being both equitable and economical, and have pointed out that the principle of 'economy' is violated if a tax is either relatively costly to collect or has mischievous effects on the production of wealth. This last consideration might perhaps be advantageously treated under a separate heading—Expediency. The distinction between Equity and Expediency is that the former looks, as it were, backward, and asks what existing or preceding circumstances make it reasonable to demand from any class a particular contribution to the public purse; while the latter looks forward to anticipated

consequences and asks what classes will ultimately gain or lose by the proposed tax, and what will be the social and political effects of imposing it. The two principles may easily clash. Thus we may decide that it would be equitable in a particular country at a particular epoch to tax heavily the capitalists, by demanding from them a percentage of the interest that they are receiving. But if such a tax is likely to hinder the process of saving by which capital is accumulated, the ultimate harm to the mass of the nation resulting from the limitation of the means of production (in the form of factories and machinery) may be so great that it would be better for them to submit to apparent injustice than to advocate the suggested tax. India at the present moment stands in especial need of increasing its capital in order to diversify its industries and especially to increase the number of occupations open to people of education. Such capital is most readily obtained by a poor country from abroad, either through direct public and private borrowing or by the investment of foreign capital in Indian industries—what is commonly called the “exploiting” of the

country by foreigners. Any tax on interest, by checking the influx of capital, would be so harmful, that however convinced a statesman might be that the foreign capitalist *ought* to be made contribute more largely to the State, he would be likely to shrink from such proposals on the ground of inexpediency.)

§ 13. Besides being equitable and economical it is desirable that a tax system should possess as much "Elasticity" as possible. That is to say, it should be easily capable of considerable expansion in times of emergency.

A single tax is said to be elastic if with each increase in the scale there is a nearly proportionate increase in the total yield. It is seldom possible for a Government to be certain of the extent to which any particular tax is elastic. Circumstances may necessitate an addition to the total revenue; the Government may expect to procure it by a change in the scale of some particular tax; but when it attempts to enforce the change, the result, owing to evasions on the part of taxpayers, or their substitution of one commodity or form of procedure for another, may result in little or

no additional revenue, or even in an absolute diminution of revenue.) Only actual experiment can determine decisively how far a tax is elastic. In the case of a tax affecting a particular commodity, any increase in the scale means an increase in the price; and so, if the *demand* for that commodity, at prices in the neighbourhood of the existing price, is elastic, so that the increase of price due to the increase of the tax leads to a considerable falling off in the quantity purchased, the *tax* will be an inelastic one.

7 A tax system, similarly, is said to be elastic when it is possible to increase without grave difficulty the total revenue received, either by slight increases in the scale of the different taxes of which it is composed, or by the introduction of very slight changes in the items which make up the whole scheme of taxes (changes of a kind that do not radically change the character of the system).

§ 14. The population of no modern state is completely homogeneous. Even if all are of one racial type they are certain to be differentiated into economic groups and social strata whose separate interests frequently diverge widely.

(Every special form of tax, other than the practically unworkable one of a universal income- or expenditure-tax reaching from the very richest to the very poorest, is bound to have indirect economic and social consequences) other than those primarily aimed at. If a customs duty is levied on the importation of a particular commodity which can be produced free of tax within the country, not only will it encourage the flow of capital, organising ability, and labour from other pursuits (which will in consequence suffer some, though not necessarily equal, depression), it is likely to benefit one social class more than another (encouraging the growth in numbers, possibly of the lowest grade workman, possibly of the intelligent sections of the middle classes) and it is likely also to benefit one or more geographical districts at the expense of others. This last mentioned consequence is of especial importance in the case of vast, diversified countries like India and the United States. In an early period of American history (1833) it very nearly led to Civil War between the free industrial North and the slave-holding producers of raw materials in the South. A

similar cleavage of interests is noticeable at the present moment (1910) in Canada between the industrial East and the agricultural West. It is noticeable even in so small and so closely knit a country as England, the last elections (1910) showing that opinions in favour of free trade and protection follow in the main certain geographical lines separating sections of the population with different industrial interests; for it is clearly impossible for the State when it interferes with the course of industry and trade to give a "preference" to everybody.

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Similar consequences will follow if the import duty is accompanied by an excise on home production; for in that case the raising of the price discourages the consumption of the commodity, and capital, organising ability, and labour tend to flow out of the industry which is penalised by the tax.

(Moreover in the case of a country like India it must not be forgotten that the relative immobility of capital and labour render the sufferings of those who bear the ultimate burden of most commodity taxes far heavier than in Western lands.)

This being the case, there is usually a strong presumption against the introduction of new commodity taxes, as they tend on the whole to prevent the social unification of a State by their embittering class hatreds. This consideration may, however, be overridden by other considerations of greater temporary or permanent importance. And in any case it must not be forgotten that every tax lays a special burden on one class or group from which other sections escape; *every* tax is harmful in itself, however great the ultimate benefits derived from its imposition. These evils are unavoidable. But they are especially noticeable in the case of import duties. As, however, the advantages accruing to special interests from the imposition of special customs duties are generally more conspicuous than more widely diffused injuries inflicted on the nation at large (this form of taxation is much used by despotic class governments and by weak governments that wish to attract to themselves the political support of powerful economic groups,) and desire at the same time to conceal as far as possible the burdens which the mass of their subjects are called on to

bear. A disinterested democratic government which has complete confidence in the public spirit of its subjects aims at making clear to all taxpayers the precise extent to which each is compelled to contribute and the precise objects for which the contributions are demanded.

§ 15. This gives us one of the most significant practical differences between direct and indirect taxes. (By "direct" taxes we mean those which are paid to the Government by the person who himself bears the main part of the burden of loss involved in the payment. By "indirect taxes" we mean those the chief part of the burden of which is borne by people who do not themselves make the actual payment to the Government.) (This classification is theoretically unsatisfactory owing to the existence of intermediate forms. But we may be content with it as a rough working division.) Thus an income tax or a land tax will be called "direct"; a customs duty which is paid by the importing merchant, who in consequence raises the price of his goods for the consumers, will be called "indirect." The advantages and disadvantages of the direct

and indirect forms are largely connected with the advisability of openness or concealment. Thus even a disinterested government will often aim at concealing the burdens connected with unpopular forms of expenditure, such as (in England) State expenditure on education; but if it wishes to impress upon the masses the folly of a needless war into which it has been driven by popular outcry, it will endeavour to make clear to everyone what taxes have been necessitated by the cost of the war. Indirect taxes unless suddenly imposed on a large scale tend to escape the notice of the taxpayer. The effects of taxation on prices are not distinguished from the effects due to good and bad seasons, to changes in methods of production, and so forth.) The taxpayer becomes habituated to the higher prices of the taxed commodities and forgetful, therefore, that with each purchase that he makes he is not only meeting the real cost of what he buys but is also contributing something to the upkeep of the State. Direct taxes cannot so easily be concealed.

§ 16. Economists classify the different factors which co-operate in all production, and the

remuneration which they severally receive, under four heads :

- (1) Land, the owners of which (landlords) receive Rent ;
- (2) Labour, which receives Wages ;
- (3) Organising ability, the suppliers of which (entrepreneurs) receive 'Earnings of Management,' or 'Net Profits' ; and
- (4) Capital, the owners of which (capitalists) receive Interest.

By Capital is meant all forms of produced wealth (wealth other than Land) which aid in the production of further wealth.) Its typical forms are: instruments of production, called often 'auxiliary capital,' such as buildings, railways, tools and machinery ; and stores of food and clothing, called usually 'consumption capital.' Seeing that the organisers of industry, or entrepreneurs, are themselves usually owners of capital, non-scientific books frequently use the word 'capitalists' to cover both capitalists and entrepreneurs ; and the word 'Profits' (beside many other vague uses) is applied to the income of the capitalist who is also an entrepreneur—an income which is

made up partly of interest and partly of earnings of management, and had better by us be designated 'Gross Profits.'

This classification of economic factors, functions, and forms of income, has been devised by Western economists for the purpose of discussing distinctively Western problems. Its applicability to Indian conditions is not at first sight very obvious, though by the exercise of careful thought it can be shown that for theoretical purposes it will hold good for them also. Its practical value in the East is, however, much less than in the West. In England the mass of working men whether engaged in agriculture, in manufactures, or in commerce, own neither the implements nor the material that they use in producing commodities for the market, nor are their incomes immediately affected by the fact that the goods are sold at a high price or a low, or left unsold altogether. The bulk of the land is in the hands of landlords who do not themselves farm it, and it is exceedingly difficult for a poor man to get possession of a small plot to cultivate for his own use, either as owner or as tenant. Small capitalists are

numerous, who live either wholly or partially on the interest that they receive on their own or their parents' savings, and multitudes of the working classes also have small sums deposited in banks or in joint stock companies, from which they receive interest or dividends.

Other differences between the structure and working of Eastern and Western society that Indian students need to bear carefully in mind when reading English treatises are concerned with the relative looseness and flexibility of social relations in the West. (Members of all classes in England adopt trades and professions with a freedom that is only slightly hampered by restrictions due to the occupations of their parents.) The range of choice open to an English boy is, of course, narrowed by limitations resulting from differences in the cost of training for different careers, so that it is usually difficult (for instance) for the son of an unskilled labourer to become an engineer. But none the less there is a considerable movement of individuals from class to class perpetually going on.

This mobility as regards occupation renders the average Englishman (and still more the

average American or Colonial Englishman) much more on the look-out for opportunities of bettering himself by change of locality or change of occupation, and much more alert to seize such opportunities than is usual in countries where restrictions of class and caste are more binding. (This freedom of movement is always taken for granted in Western textbooks when they are dealing with the remote effects of different forms of taxation.) It is assumed that if a new tax favours one industry or locality more than others there will be a fairly rapid flow of young untrained labour from the latter to the former; and that such suffering as may be involved will be comparatively brief and transitional.

Similarly it is taken for granted that the growth of population as a whole, and the relative growth of the larger divisions of which it is composed, will respond naturally to changes in national and class prosperity without any of the sharp "positive" checks of drought and famine to which the East is only too sadly accustomed. In times of working class prosperity, more working men marry, they marry younger, they have more children,

and more of these children survive the ailments of childhood; and thus increased prosperity means increase of numbers. When "times are bad," marriages are indefinitely postponed and a check is given to the growth of numbers, which quickly operates in at least modifying the downward tendency of working-class incomes. (In India, where religious considerations and social habits make the practice of early marriages almost universal and very nearly compulsory, there are no such automatic "preventive" checks on the growth of numbers.) A section of the Indian people which finds its opportunities of a satisfactory livelihood passing away endures sufferings much more terrible than are to be expected in similar circumstances in the Western world.

§ 17. Still this Western economic classification of society should be borne in mind when we are endeavouring to think out the ultimate consequences of imposing any new form of tax. It is a convenient guide which should prevent us from wholly overlooking any one interest. But at the same time it should be pointed out that it is of little use to attempt, as early

writers on Public Finance ordinarily attempted, to classify taxes according as they seem to fall on one or other of these four groups. (It is practically impossible to impose taxes on Capital in general or on Labour in general, and it is better, therefore, to proceed directly to the consideration of such taxes as can in practice be imposed.)

It will be well, however, to touch on a few important generalisations before we proceed.

The phrase, "a tax on capital," is a very ambiguous one. It may refer to a tax levied on the members of the community in proportion to the amount of property that they possess; and such a tax, if small, would probably be met in the same way as other taxes, by the taxpayers curtailing somewhat their total expenditure. But sometimes the phrase is used to designate a tax which tends to be "paid out of capital," that is to say, a tax which is met by the taxpayer reducing not his expenditure but the total amount which he looks upon as the capital from which he derives an income. Heavy death duties are held by many writers to be liable to the objection that they tend to "fall on capital" or to be "paid out of capital," because the

receiver of a bequest immediately pays what the State demands and considers that the remainder constitutes the whole of his inheritance; whereas if the State demanded the same amount gradually in the form of increased income-tax he would probably endeavour to pay it by reducing his expenditure, in order to preserve the capital value of his inheritance intact.

There are seldom nowadays heard proposals to put a direct tax upon wages in general. A tax on the necessities of life while affecting all classes of the community acts, however, in Western countries where the working classes are mainly wage-receivers, very much like a tax on wages.

A tax on "profits" (in the form of net earnings of the entrepreneur class) would involve too many difficult problems of assessment. (Entrepreneurs' profits are usually attacked by way of income taxes and stamp duties imposed on various forms of commercial transactions.) "Profits, in my opinion," says Professor Marshall,¹ "are not an economic entity. They

¹ *Memoranda chiefly relating to the classification and incidence of Imperial and Local Taxes* [C. 9528]. Price 2s. This is a government publication, a blue-book which takes

include some interest on capital, some earnings of ability and work, and, often, some insurance against risk. . . . The elements of which profits are composed obey different laws, and they enter in different proportions (whatever definition of 'profits' be taken) in different industries, in the same industry in different places, and in large and small businesses even in the same industry and in the same place. It would, for instance, be necessary to discuss on different plans the profits of a large joint stock company, where salaries of a thousand a year are not reckoned with profits; and those of a small tradesman whose profits include the earning of much manual labour. Some taxes on profits would increase the influx into the learned professions, and tend to lower the earnings of medical men. . . . All taxes on profits would tend to check the growth of capital and to increase its emigration; some of them would tend perceptibly to increase the emigration of persons and so on.)

the form of answers to a set of questions (a sort of examination paper) which was submitted to the leading professors of political economy in 1897. Professor Marshall is here answering a question about the taxation of 'trade profits' ('gross profits' as defined above).

CHAPTER II

LAND REVENUE

§ 18. THE general reasons why the Land Revenue must in India form the central feature in the Tax System (constituting in fact nearly two-fifths of the total net revenue) have already been given. These reasons prevent the Land Taxes of India from being in any way comparable to the Land Taxes levied in other countries where they play only a subordinate part in the whole tax system. But in all cases a tax on land ought to be so adjusted that any variations in the amounts demanded, or any anticipated variations therein, will not discourage cultivators from introducing improvements (as would be the case if, *e.g.*, the State demanded a definite proportion of the gross produce). In England most agricultural land is the property of great

landlords. Tenants hire the land for a number of years at a time, and at the end of the term are entitled to compensation for "unexpired improvements." In India nearly half the land (47 per cent.) is *ryotwari* land held by peasant proprietors dealing directly with the Government; the remainder is *zamindari* land held either by individual landlords, or by village communities who act as corporate landlords in relation to the cultivators. In the case of the former, the *ryotwari* lands, it is possible to some extent for the Government to make its reassessments in such a manner as not to discourage improvements. In the case of *zamindari* land the problem is more difficult, necessitating much governmental intervention between the *zamindars* and their tenants.

The value of land and its produce, it must be pointed out, tends to vary partly as a consequence of the exertions of the actual cultivators and partly as the result of economic causes of a more general kind. As instances of the latter we may take the rise in the value of land when a railway is built in the neighbourhood (enabling the farmer to

market his produce more economically) or when irrigation works are constructed (rendering the whole district more fertile). Similarly, if population increases rapidly in a particular district the land (being in more demand) rises in value, especially if it is needed for buildings of a commercial character, or if a growing town population in the neighbourhood calls for an increased output of agricultural produce. On the other hand, striking instances may be cited of an opposite nature. Agricultural land in England has greatly decreased in value during the last thirty years owing especially to the opening up of railways in North America, where wheat can now be grown and transported to the English markets more cheaply than it can be produced in England.) Land in India used for the growing of indigo, of which India had formerly a virtual monopoly, has similarly been disadvantageously affected by the discovery of artificial means of producing indigo in Germany. Changes of these kinds, not being due to the efforts or the indolence of landholders and cultivators, are known as “unearned” increments and “unearned”

decrements. (In so far as they are increments due to the action of the State (due, *e.g.*, to the construction of irrigation systems) it is obviously right that the increment should be appropriated by the State.) In so far as they are due to the activity of the whole community (consequences, *e.g.*, of increasing population and prosperity in the neighbourhood) they may with almost equally unquestionable justice be appropriated by the Government as the representative of the community's financial interests. In the case of the increments being due to improvements introduced by the Indian cultivator the problem is not equally simple. The Indian Land Taxes resemble, broadly, the English Income Tax. (An Englishman's income may rise from year to year as a consequence of his own exertions. This is never given as a reason for not increasing the amount demanded from him in income-tax) except to a small degree by some writers, who argue that the additional income that he gets as interest on the savings accumulated by his own exertions ought to be exempt from taxation). On the same principle the Indian Government

ought not to debar itself entirely from raising the scale of the Land Tax in all cases where the improvements are due to the cultivator's exertions. But, on the other hand, it must—even from motives of mere administrative expediency—refrain from raising it in such a manner as to make it no longer worth while for cultivators to introduce improvements. For if it does so, it checks the increase of the national wealth from which all its revenue is derived and is itself ultimately the loser by its short-sighted policy.) This folly has in the past been frequently committed by the Bengali *zamindars* in their private dealings with their tenants; their own contributions to the State having been permanently fixed, they have proceeded to exact such rents from their tenants as have only just enabled them to continue cultivating, and left them with no inducement to do more than gain a bare subsistence from the soil.¹

¹ See, for instance, the Moradabad Settlement Report, 1881. "The conditions on which the peasantry now live and till the soil are adverse to any solid progress. . . . The great incentive to industry is wanting. He knows that the more he toils the more he will have to yield to his landlord." (Quoted in Sir T. Morison's *The Industrial Organisation of an Indian Province*, 1906, p. 49.)

Failure to recognise the normal tendency of land values to increase with the growth of population and prosperity led the Indian Government to commit in the early part of the nineteenth century what is now recognised to be a grave error—that, namely, of fixing in perpetuity the amount of the contributions to the State to be demanded of the *zamindars* of Bengal. (Failure to realise the discouragement of economic progress caused by frequent changes in the State's demands led the Government in the middle of the century into what was perhaps also an error—the too frequent succession of reassessments.) The happy mean in this matter is evidently most difficult to define and attain. “At length” (says one of the annually published blue-books in which the aims and actions of the Government are explained ¹) “over the greater part of India a system of periodical settlements was established, under which the State demand is revised at recurring periods of ten to thirty years, the latter period prevailing in all the larger provinces except the Punjab and the Central Provinces, where settlements

¹ *Moral and Material Progress of India*, 1908-9, p. 22.

are usually made for twenty years, and in Burma, where the ordinary term is now fifteen years. At these settlements careful surveys are made of all holdings and records of rights in the land. The policy of long term settlements is being extended. Under the system of periodical revisions of the land assessment (the State secures a share in the increased rental value arising from the general progress of the community. Of late years measures have been taken to exempt improvements from assessment,) and generally to make the enforcement of the rights of the State as little burdensome as is possible to the revenue-payer. Periodical revision also affords the opportunity of reducing the assessment in villages or tracts which have declined in prosperity, and of correcting inequalities arising from any cause."

. . . "Settlements (or re-settlements) in new or in temporarily settled areas are always in progress. In consequence of improved methods the period occupied in the process is much shorter than formerly, and involves comparatively little harassment of the people."¹

Owing to the circumstance that, in days of

¹ *Moral and Material Progress of India*, 1908-9, p. 24.

less theoretical knowledge and less experience, it allowed itself to promise never again to raise the amount of Land Revenue to be demanded from the landlords of one-fifth of the total surveyed area of India, and also to the fact that in many other districts it has had, owing to the scantiness of the information at its disposal, to be guided by what the cultivators had been accustomed to pay to earlier landlords and governments, the present Government of India has been prevented from following out any single theoretical scheme for the whole of India in such a way as to satisfy fully all the claims of absolute equity. It is impossible to break the definite engagements made with the Bengali *zaminclars*; it is impossible also, without resort to costly methods of coercion, to compel backward populations to supply information which they desire to conceal, or to make payments of a kind which they may happen to consider inequitable because contrary to custom; even though, by completely ignoring custom and by deliberately cancelling the promise made at the permanent settlement of Bengal, it might be possible to distribute the burden of the land taxes more equitably over

all classes of cultivators.) A mistake similar to that of the permanent land settlement in India has been made in most Western countries where the "unearned increments" in the value of land have been allowed to pass into the pockets of landlords tax-free. Western democracies are awakening to the evil involved in this error, and the English Government intends henceforth to tax all future increments of this type, though it considers itself bound by a tacit promise (similar to the explicit promise made to the Bengali zamindars) not to tax such increments as have already accrued.

With regard to the principles which have governed the assessments in provinces not permanently settled, Mr. B. H. Baden-Powell writes as follows.¹ "Assessment methods have of course to vary according to the kind of estate and its mode of working. But practically underlying all methods, there are only two principles which emerge as ultimately distinct. One is to fix empirical rates, which are first ascertained only as maximum rates, on the basis of those actually paid in the past,

¹ *Land Revenue of British India*, 1894, pp. 47, 48.

but with such increase as can now be taken with reference to the rise in prices and progress in prosperity indicated by statistics, and then to apply those rates, in full or in part, according to a sliding scale, the land being accurately valued according to the relative excellence of one kind of soil as compared with another. The other principle is applied to all varieties of landlord estate (including village estates) where there are tenants; and it consists in finding out the rents which the tenants actually pay, and thence devising average rent-rates at which each acre of the different classes of soil in the estate may be valued. (The Land Revenue is then a fixed fraction of the total rental 'assets.' To put it more shortly, modern Land Revenue is either an empirical but nicely graduated rate per acre of each kind of soil, or it is a fraction of the actual rental assets of an estate treated as a whole.")

All this indicates how impossible it still is, in the case of India, to apply in all their fullness the abstract principles of Equity, previously discussed (pp. 9-20). This is largely due to the immense difficulty of gathering infor-

mation of an economic kind anything like as full and accurate as the information we have been able to obtain in Western Countries. Such information can only be gradually acquired by Governments possessing a highly trained civil service, and its acquisition is often a costly matter. In England the permanent civil service is perpetually tabulating statistical information and pouring out every week masses of printed material¹ of a kind likely to assist Cabinet and Parliament in the work of legislation and to enable the intelligent sections of the public to criticise effectively the activities of the State. (Yet even here, one of the strongest objections urged against the newly introduced principle of taxing future unearned increments in land values has been the immense cost which the necessary surveys will involve.) Yet periodical assessments for the Land Revenue can no more be dispensed with in India than can in England the annual assessments of all members of the middle and upper classes by the Income Tax Commissioners. The latter is, of course, much the less expensive process, as the tax-

¹ See Preface.

payers themselves return statements of their average income for the three preceding years, and only when there appears a strong probability of 'considerable under-statement do the Commissioners set aside these returns.

§ 19. The much-argued question—whether the Land Revenue in India partakes more of the nature of a tax or of rent—seems to me to possess not even an academic interest. In Medieval Europe there was an almost complete blending of the functions of landlordism and government, which modern students are inclined to consider an unnatural and undesirable confusion. The feudal vassal paid to his feudal superior a contribution, in commodities and services, that cannot be described as distinctly a tax-payment in return for military defence and similar governmental work, nor yet as an ordinary rent. (In Modern Europe the agricultural population pays usually a double tribute, consisting of rents to landlords and taxes of various kinds to Governments. Both are deductions from that aggregate of commodities and services which constitutes the "National Dividend" otherwise available for distribution among the active

factors of production. Both in themselves constitute burdens which economic competition diffuses over the whole body of producers.)

In so far as Government officials and landlords render, in return, real social services—the expenditure of energy in the collection of tribute is not itself a social service—this burden is neutralised. Well-administered taxation is in such cases, in its bearing on the community as a whole, “beneficial”¹ and not “onerous”;¹ and if landlords ordinarily endeavoured to act on the assumption that they are public servants equally with ordinary State officials, rents likewise might be described as sometimes “beneficial” and not “onerous.”

The question—whether the payments exacted in *ryotwari* districts are of the nature of taxes or of rents—could never have been raised except by theorists so accustomed to Western conditions of land-tenure that they have come to assume that there *ought* always to be rents paid to irresponsible private landlords, and that what the Indian Government takes as land revenue is therefore merely what the unchangeable nature of things demands

¹ For these terms see p. 84, *infra*.

should always be paid to *somebody*; so that if the Government steps into the place of this *somebody*, they argue that it is not making any deduction from the National Dividend otherwise available for distribution among the working factors of production. How far such an assumption is justifiable it is for the reader to judge for himself.

The peculiar virtue of such part of the land revenue as falls on pure economic rent should, however, be obvious from a little consideration of the nature of rent—which is itself (as has been just pointed out) somewhat of the nature of an additional tax levied by private owners on the active wealth-producers of the country. (A tax on economic rent diverts part of this tribute from private pockets to the public purse, without producing such harmful effects (see § 12) as accompany attempts to tax capital.)

CHAPTER III

COMMODITY TAXES

§ 20. FOR the past fifty years (since 1860) English Governments in drawing up their budgets have endeavoured very scrupulously to maintain the policy of Free Trade.) By Free Trade is meant, not the absence of all customs duties on imported goods, but the absence of customs duties levied in such ways as are likely to favour certain groups of producers at the expense of others. It implies the attempt on the part of the State to frame its customs tariff on purely *revenue* principles, obtaining as large a contribution as possible from the importers of goods without causing any appreciable diversion of capital, organising ability, and labour from one industry to another; though (it should be mentioned) the

British Government has also been influenced, in the case of alcohol (and perhaps to some extent in that of tobacco) by the desire to diminish the consumption of a noxious commodity.¹ Accordingly there has been selected a short and simple schedule of imported commodities such as could not in any circumstances be produced in the British Isles—sugar, tea, coffee, cocoa, dried fruits, and now also petrol—to which are added tobacco (the cultivation of which is practically prohibited within the country) and alcohol. Alcoholic drinks are extensively manufactured within the kingdom, but an excise, a tax practically identical in amount with that levied on

¹ The same principle of checking harmful consumption has been adopted by the Indian Government. The following is from the speech of the Finance Member introducing the Indian Budget for 1910-11. "What we now propose is a set of rates which, in the case of cigarettes, is represented by Rs. 2 a lb. They may diminish import for a time, but incidentally they may check the rapid growth of the cigarette habit, which is not without its danger to the rising generation in India." . . . "We retain full liberty to protect the legitimate household and medicinal use of opium; but increasing stringency against its use as a luxury or an intoxicant, higher rates of duty and more vigorous preventive action, command our entire approval." Compare also the despatch of the Government of India quoted in Sir John Strachey's *India: Its Administration and Progress*, 1903, pp. 168-170, and the quotations in § 24, *infra*.

imported alcohol, is exacted from all English brewers and distillers.

It will be noticed that the commodities chosen are, with the exception of petrol, widely used consumption goods. They are not what are usually called manufactured articles; and they are not to any appreciable extent the raw materials of other industries. They are fairly easily identified by customs officials, and they cannot easily be smuggled into the country in large amounts. Moreover it is easy in the case of all of them to make the tax *specific* and not *ad valorem*. A customs duty is said to be 'specific' when the commodity is taxed so much per unit (per pound weight, or per gallon); it is said to be '*ad valorem*' when the tax levied is a percentage of the estimated value of the particular goods imported. One seeming disadvantage of the specific form is that it involves a relatively heavier tax in the case of the poorer and cheaper qualities, and therefore imposes a heavier burden on the poorer consumers of the goods than on the richer. This, in the case of the English system, is, however, hardly to be counted a drawback because, as was

pointed out earlier, one leading object of imposing commodity taxes of any sort is to exact an equitable contribution from the working classes who are not subjected to the income tax.¹) Nor, it may be pointed out here—and this is an important consideration not only when we are dealing with the English customs duties but also when we are treating of Government monopolies and commodities subjected to excise duties, as in the case of salt in India—is it possible to estimate the *burden* of a tax by calculating what proportion the tax bears to the original cost of the commodity; the extent of the burden depends on the total amount paid by the consumer considered in relation to his income,² some allowance being made in the calculation for the loss of utility due to lessened consumption. The great advantage of the specific form of duty lies in economy of collection. Expert valuers are not required at the customs houses, the task

¹ The petrol tax, however, is a recent addition intended to act as a luxury tax paid by the wealthy users of private motor cars. In the case of petrol used for other purposes one-half of the tax is remitted.

² In the case of the Salt Tax this amounts to about $2\frac{1}{2}$ annas per annum per head of the population.

of officials being limited to that of ascertaining the amounts and not the qualities of the goods they have to handle. Moreover, the importers are never in doubt as to the duties that they will be called upon to pay, and so are never subjected to the inconvenience of uncertainty as to what charges they will have to meet. (Uncertainty on this point, it may be pointed out, is a serious handicap to traders in countries with clumsy and backward customs systems.)

§ 21. In the case of India it has not been possible to maintain so fully the Free Trade principle. As in England, it has been found necessary to levy import duties in order to increase the total revenue. But there is no convenient list of widely used commodities which are not raw materials of industry and not produced within the country. Accordingly a five per cent. *ad valorem* tax is levied on imports in general, with a considerable number of exemptions and remissions in the case of the raw materials of industry.) (The fact that practically all imports are taxed does not, however, mean that the yield from the customs is proportionately large. Excluding salt, the duties from which appear under a

different heading, about two-thirds of the customs revenue is derived from five heads—cotton manufactures, liquors, silver, sugar, petroleum—and indeed the total receipts amount to less than five million pounds, a contribution of less than four annas per head of the population; while the brief English schedule yields over thirty millions, or more than forty times as much per head of the British population.¹) The duties in the main are necessarily *ad valorem*, as highly manufactured goods, such as clothing and machinery, cannot be taxed a definite amount per unit, unless a schedule be drawn up, enumerating many thousand different items, and requiring continual revision as prices change or new types of goods are introduced. Manufactured cotton goods pay $3\frac{1}{2}\%$ instead of 5% (with a corresponding excise on home manufactures); vinegar and copperas, $2\frac{1}{2}\%$; iron and steel manufactures, 1% ; and there is a considerable “free list” of untaxed imports.² Specific duties are imposed

¹ See also the comparisons, § 37, *infra*.

² For details, see *Statistical Abstract for British India*, appendix. The chief items are railway materials, machinery of various sorts, grain and pulse, living animals, coal, jute, raw cotton and wool, books, gold and unset stones.

on imported fire-arms, opium, petroleum, silver,¹ salt, salted fish, and liquors of various kinds: and special *ad valorem* duties upon ammunition and spirits. There are also specific duties on exported rice and tea, the proceeds of the latter (a trifling amount) being paid to a Tea Cess Committee appointed to promote the sale of Indian tea.

(It should be noted, however, that the Free Trade principle is thus far adhered to, that the scheme does not aim at giving special favours to particular industries at the expense of others. In other words India has a "Revenue Tariff," not a "Protective Tariff.")

§ 22. The policy of favouring particular classes of producers by means of special customs duties is known by the name of Protection. Protectionists are to be found in all countries, but their aims and arguments differ widely according to the diverse conditions of the different

¹ The recently increased duty on silver is not only financially productive; it has also much the same to be said in its favour as can be said in favour of the taxation of commodities of a noxious character. For wealth which takes the wasteful form of silver hoards and silver ornaments is socially unproductive; and the Indian practice of allowing it thus to lie idle involves a serious loss of much-needed economic power.

countries concerned. Thus in England many Protectionists advocate customs duties on imported wheat, so that farming may become more profitable, and the flow of the population from the country districts to the cities may be checked (it being thought by many that a rural population is healthier and more moral than a town population, and that every country ought, for military reasons, to be able to produce its own food supply.) In India the argument is naturally reversed. It is with the hope of checking what Mr. Justice Ranade describes as "the gradual ruralization of this great dependency, and the rapid decadence of native manufacture and trade"¹ that Protection is usually advocated in India.

The transition from the status of a predominantly agricultural to a predominantly manufacturing country may be dated, in the case of England, as commencing about the middle

¹ *Essays on Indian Economics*, Madras, edition of 1906, p. 107. It may be worth noting that this economist admits that the tendency is no longer marked. "It is" (he writes) "a most fortunate circumstance that, during the last twenty years, there has been a clearly distinguishable departure from the till then unimpeded process of ruralizing a vast continent long known for its great resources and aptitudes." *Ibid.* (This address was written in 1893.)

of the eighteenth century, roughly 150 years ago. (It was due mainly to discoveries with regard to the possible uses of coal and steam and to a long series of mechanical inventions which have rendered possible the large-scale production methods of modern times.) Previous to this Industrial Revolution such industries as spinning and weaving were carried on by hand in the country villages, very much as they are to-day in India. The transition from the old methods to the new caused fundamental alterations in the distribution of the population, increasing enormously the numbers in the towns (especially those which sprang up, as a consequence of the Revolution, in the north); while it changed utterly the habits of life and the economic outlook of the working masses, whose sufferings during the period of transition, owing to their inability to adapt themselves to the rapidly changing conditions, were almost as great as those of an eastern population passing through a prolonged famine period. In Eastern countries, such as Japan and India, a similar revolution is beginning. Owing, however, to the greater experience of modern Governments, who have before them

the history of the Industrial Revolution in Europe, it is to be hoped that the sufferings endured in England will not be reproduced on the same scale, though there is reason to fear that the beginnings of the change are causing much misery already among the workers in Japan.

The pre-eminence of England in manufacturing was mainly due to the fortunate conjunction of coal and iron deposits in the same localities (a vitally important consideration in the days when methods of transport were very undeveloped), to priority over other countries in the great inventions; to a specially damp climate in Lancashire which renders that county almost uniquely adapted for producing the finer types of spun cotton; and to the country's immunity from invasion during an important period of the Revolution, the years 1792 to 1815, when the continent of Europe was being continuously devastated by war. There is no reason to believe that her advantages were increased by the clumsy customs tariffs of the period.)) These tariffs were imposed by statesmen possessed of little knowledge of trade conditions, whose main

object was to raise as swiftly as possible vast sums to be expended on warfare with France. (These wars, 1793—1815, are responsible for about two-thirds of England's enormous public debt.) The duties bore equally heavily on food supplies and on raw materials; the complexity of the tariff was a perpetual source of annoyance and inconvenience to traders; and there were few foreign manufacturers who could, in any case, have competed against English manufacturers in the English markets.

A considerable section of Indian public opinion desires to hasten the Industrial Revolution in India. They speak as Mr. Justice Ranade speaks, of the "progressive ruralization" of India in the nineteenth century. It should, however, be noted that the change thus referred to is the partial decay of the village industries, due to the competition of machine-made goods, and not any relative growth in the rural population; so that the term "ruralization" is hardly the most satisfactory one that could be used. (The decaying village industries can hardly be resuscitated by any artificial means. What Indian

Protectionists desire is the stimulation of factory production with the object of diversifying national industries and in the hope of increasing national wealth.)

The device by which they believe that this change can advantageously be hastened is the imposition of "Protective" duties on imported manufactured goods, duties, that is to say, not counterbalanced (as are the present duties on cotton goods) by an Excise on similar Indian manufactures. Such duties, by raising for foreigners the cost of marketing their wares in India, would give Indian manufacturers an advantage in competition that would enable them to sell more of their products at higher prices. Thus all consumers of the goods, by paying more dearly for them, would be taxed for the purpose of aiding the manufacturers. This burden on the agricultural classes, already declared by many to be over-weighted with taxes, should be borne in mind when the expected advantages of the stimulus to manufactures are being discussed. Moreover, it should not be forgotten that such customs duties, by reducing the amounts of imported manufactures, involve incidentally a reduction

in the export of agricultural produce, thus causing additional injury to the agricultural population. For the manufactured goods that India now obtains from England are not paid for in gold and silver (of which India imports on the average over £8,000,000 worth more than she exports) but by means of "bills of exchange" and similar documentary promises to make payment. These documents are sold in London by the English exporters (and also by the Secretary of State for India, who has to make many payments in England on behalf of the Indian Government); they are bought up by Englishmen desiring to import such things as raw cotton and wheat from India; they are then sent back to India in payment for these products, and the Indian sellers of the wheat and cotton present the documents to the bankers of the original traders who bought the English goods (or to the offices of the Indian Government at Calcutta), and demand payment. If fewer English goods are imported into India there will be fewer of these bills of exchange offered for sale in London; their price in consequence tends to rise; and fewer English importers will, as a

necessary result, be able to buy Indian wheat and cotton with advantage. Thus the burden imposed on the agricultural classes by customs duties on imported manufactures is twofold.)

There is, moreover, good reason for believing that for a long time to come India is likely to get a much greater return from the investment of capital in more scientific agriculture than from any extension of manufacturing industries. Nor must the relatively unwholesome conditions of factory labour (disclosed by recent official investigations) be overlooked.

It is considerations such as these which make most English economists, however much they may be in sympathy with the aims set forth by the Protectionists, unwilling to advocate the encouragement of industries by Protective duties. The justice of imposing burdens on the unprotected classes appears always somewhat questionable.

§ 23. Salt is taxed by means both of an excise on local manufactures and of customs

¹ The above account has been somewhat artificially simplified, complications due to such causes as the movement of capital being ignored.

duties. A certain amount is also manufactured and sold by the Government. The incidence of the tax amounts to about $2\frac{1}{2}$ annas per head. (This may be roughly calculated by dividing the total revenue received—omitting the bulk of the receipts from the sales of Government salt—by the total population.)

The original reasons for the special treatment of salt have been given on p. 20. Successive reductions in the duty in recent years have, however, resulted in such increases in consumption¹ as to suggest that the tax previously was kept unwisely high.) Owing to the decreasing opium revenue, however, it will probably be impossible, at least in the near future, to proceed much further with reduction.

§ 24. "The excise revenue" (says an official publication)² "is derived from the manufacture and sale of intoxicating liquors, opium, and hemp drugs. . . . The excise revenue from

¹ The average annual consumption is now about 12 lbs. per head, or approximately double of what it was fifty years ago.

² *Moral and Material Progress of India*, 1908-9, p. 33. (The excise on salt is treated under a separate heading.)

opium is chiefly composed of duty and vend fees, and the rate of duty varies with local conditions, being highest where smuggling is most difficult. (The right of retail vend is usually sold by auction. With regard to hemp drugs, cultivation is restricted and controlled ; a duty is paid before issue, and retail sale is under licences, which are usually sold by auction.) . . . The normal excise system for liquors, which will eventually prevail over the greater part of British India, is based on the grant by contract of the right of wholesale supply and the sale by auction of the right of retail vend. By these means the dangers of unrestricted competition for the supply of liquor and the attendant difficulty of proper supervision are avoided, while the largest possible part of the monopoly profits arising from these restrictions is secured to Government."

(In the case of all these commodities the aim of raising a sufficient revenue is combined with the aim of checking consumption of a kind that may be socially harmful.) (Cf. p. 58 *supra*.) As illustrating the complexity of governmental aims and the administrative difficulties encountered in carrying them out,

the following sentences from the same publication are instructive : "The considerable growth of the excise revenue in recent years is due mainly to higher rates of duty and stricter excise control, and does not indicate a corresponding increase in consumption, although some increase has occurred through the expansion of population, and the greater prosperity of certain classes. There has been a large and continuous reduction in the number of country spirit shops in the principal provinces. The Government consider that shops should not be so few that each has a monopoly over a wide area, lest prices should be unduly raised and illicit practices encouraged. Measures are being taken both to redistribute and to reduce the number of existing shops, as well as to improve the quality of the liquors sold. The Government . . . in a Resolution dated September, 1905, . . . declared that . . . their settled policy was to minimise temptation for those who do not drink, and to discourage excess amongst those who do. The most effective way of forwarding this policy was to make the tax upon liquor as high as

possible without stimulating illicit sale and production, and without driving people to substitute deleterious drugs for alcohol, or a more for a less baneful form of liquor.”)

CHAPTER IV

OTHER SOURCES OF REVENUE

§ 25. THE Indian Government resembles the British Government in abstaining as far as possible from interference with the course of ordinary trade. But to a much larger extent than most Western Governments it is a direct participator in commercial undertakings from which it derives profits that help in maintaining the direct tax revenue at its present extraordinarily low level. (The Government of the United Kingdom derives a small annual profit from its shares in the Suez Canal Company, and a still smaller profit from the Crown lands; but its only other commercial undertaking is the management of the postal and telegraphic business of the country.) From this it reaps only a moderate profit, as it aims rather at the social benefits that result from a trustworthy

regular service than at a large addition to the revenue. The Indian Government, besides the postal and telegraphic services, which are run on the same general principle as in England (the rates of postage being kept lower, I believe, than in any other country in the world), controls and makes profits from railways, forest lands, salt-works, and the marketing of opium, and by its irrigation works continually makes possible the settlement and cultivation of new lands the revenue from which also may reasonably be classed as commercial profits.

§ 26. The Forest Revenue, which for administrative purposes is classed with the Land Revenue, should, perhaps, for theoretical purposes, be treated along with other commercial undertakings of the Government. (It is made up of royalties on timber and other forest produce, proceeds of the sale of the same, and fees charged for permission to graze cattle, or to extract timber, firewood, charcoal, bamboos, canes, and minor forest produce. Over against the gross revenue obtained is set the expenditure on conservation and reproduction of trees of various sorts, the more valuable of which

in each province are declared reserved trees, and may only be felled under special licence. This expenditure swallows up quite half the gross revenue, but it is largely capital expenditure such as is likely to increase greatly the future yield.

§ 27. From opium is derived a revenue which is partly of the nature of an excise (discussed in the preceding chapter), partly of customs duties on imports from Baroda and other Native States, but mainly of monopoly profits from the sale for export of the produce of the crops grown under the control of Government. Poppy cultivation is permitted only in specified areas. (The cultivators must receive licences and are required to deliver the whole of their outturn of crude opium at a fixed price to Government agents. It is then prepared for export in Government factories and sold by auction to intending exporters,) excepting a small quantity, which is made over to the Excise Department for home consumption.

A careful account of the history of the opium trade, and of the working of the present system, by Mr. G. H. M. Batten, is

reproduced in Sir John Strachey's *India: Its Administration and Progress*, Chapter X; to which readers who are specially interested in the subject are recommended to turn for fuller information.

Unlike the forest revenue, the opium revenue is decreasing and likely to continue decreasing, owing to recent treaty arrangements with the Chinese Government, the object of which is to reduce the harmful consumption of the drug in China.

§ 28. The aim of the Income Tax is to reach those incomes which are not directly affected by the Land Taxes. Incomes derived from land or agriculture are exempt. There is a graded scale, beginning with a tax of Rs. 20 on an income of Rs. 1,000; rising to Rs. 42 on incomes of Rs. 1,999; and fixed at 5 pies in every rupee for incomes of Rs. 2,000 and upwards. In the case, however, of incomes derived from salaries, pensions, or interest on securities, the tax is fixed at 4 pies in the rupee for incomes between Rs. 1,000 and Rs. 1,999; while companies pay 5 pies in the rupee on their net profits.

§ 29. The Stamp Revenue is derived from two

very distinct sources. Most judicial documents (plaints, petitions, and the like) are required to bear stamps of specified amounts. These form a tax upon litigation. Many commercial transactions recorded in writing (conveyances, bonds, cheques, receipts, etc.) must also bear stamps. These impose a burden which is irregularly diffused over the commercial sections of the community.

§ 30. Closely akin to the Stamp Revenue is that which appears under the heading of Registration. Practically all transfers of immovable property (buildings and lands) must now be registered; and for this registration small *ad valorem* fees are charged, as well as a small fixed fee for searching the records relating to the property in question.) “Mortgages form the largest class of instruments registered. Documents relating to the sale, mortgage or lease of immovable property, compulsorily registrable, comprise about 87 per cent of all registrations.”¹

¹ *Moral and Material Progress of India, 1908-9*, p. 39.

CHAPTER V

LOCAL TAXATION

§ 31. WE now come to the important question of local administration and local taxation. Its vital significance in relation to national life is due to the political training that dealing with local matters gives to all public-minded citizens who wish to qualify themselves for the higher and harder tasks of criticising State finance. Its remarkable development in England has been pointed out by foreign observers as one of the leading causes of the comparative success of parliamentary institutions in England; and it seems clear that the absence, until recent times, of a similar training on the continent of Europe has been an important factor in rendering most foreign attempts at reproducing the central features of the English parliamentary system unsatisfactory in their practical working. Thus in

Prussia, "Professor Gneist, the great historian of the English Parliament, prepared a memoir on the subject of local government. . . . He pointed out that the imitations on the continent of the English parliamentary system had in most cases been unsuccessful, because the institutions which stood at the top of the British form of government had alone been copied, while there had been no attempt to adopt those which lay at the base of the structure. He declared that the whole English system rested on the organisation of the local bodies. . . . Bismarck adopted these views, and . . . remodelled the local government on the lines suggested by Gneist."¹

Interest in local administration is usually slow in developing, owing to the circumstance that devotion to the everyday needs of the community seldom brings the notoriety that accompanies more striking, even though less socially beneficial, activities on the stage of imperial politics.) In India the local side of political life is still in its infancy. "The

¹ Prof. A. L. Lowell, *Governments and Parties in Continental Europe*, 1896, Vol. I. pp. 309, 310.

² *Moral and Material Progress of India*, 1908-9, p. 105.

interest in municipal elections, and in municipal affairs generally" (says an official publication)² "is not usually keen, save in a few cities and large towns, but, as education and knowledge advance, interest in the management of local affairs gradually increases. In most provinces municipal work is fairly well done, and municipal responsibilities are, on the whole, faithfully discharged,) though occasional shortcomings and failures occur. The tendency of local bodies, especially in the smaller towns, is to be slow in imposing additional taxes, in adopting sanitary reforms, and in incurring new expenditure. "Many members of municipal bodies are diligent in their attendance, whether at meetings for business or on benches for the decision of petty criminal cases."

§ 32. The general principles underlying the division of taxation and expenditure between central and local authorities in a country like England are (1) that public business is managed most economically when those who bear the burden of the contributions can closely control their expenditure ; (2) that certain matters, such as sanitation, water-supply, street-lighting,

have a preponderantly (though seldom exclusively) local importance, while other matters, such as national defence, have a preponderantly imperial importance) and (3) that certain forms of public expenditure, whether their importance be mainly local or mainly imperial, are more advantageously, or else more conveniently, controlled by local than by central authorities, even though, as in the case of the English police system, the administration by the local bodies is supervised and criticised by the central Government.

§ 33. The principle of equity which is specially applied in the case of English local taxation is based on the consideration that the expenditure of local rates usually enhances the value of those forms of property that are permanently identified with the locality—namely, buildings and land.) Hence almost the whole of the revenue raised by local taxation is raised by rates on these forms of property (usually called “real” property). And the justice of this system is obvious in the case, say, of a rate for street improvements which, while compelling a land-holder to pay £5 a year in additional taxation, so

increases the advantages of his land that he is able to get from his tenants a rent greater by £5 than the rent paid before the expenditure was incurred. In a case of this kind we are really dealing with a form of compulsory co-operation between holders of real property imposed for their mutual benefit. Such rates are described in text-books as "beneficial"; those which yield no direct benefit of this kind to the ratepayers (such as poor rates and education rates) are called "onerous.")

The objections to raising money by means of local customs duties (known by the French name of *octrois*), or by local income-taxes, are obvious. *Octrois* interfere with internal trade, inflict injuries on one town in order to benefit another, and are specially liable to

¹ When we are looking at the national tax burdens in their broadest aspect in order to estimate their aggregate weight in relation to national resources, distinctions between "onerous" and "beneficial" taxation must almost drop out of sight. All wise public expenditure must be beneficial to the community *as a whole*; it must either be dictated by imperative military needs, or humanitarian considerations, or serve such social purposes as will lead to the enhancement of national prosperity and consequently of the aggregate wealth with which it is desired that the tax burden should be compared.

evasion by smuggling. Local income-taxes are inequitable, because incomes in modern times are drawn from the most widely diverse sources; and there is no reason why a petty village should be able to throw the main burden of its expenditure upon a single millionaire because he happens to have settled within its area, though his income is drawn from dividends yielded by foreign railways and distant gold mines.

§ 34. In the United Kingdom the amounts raised by local bodies of all sorts (municipal and county authorities, harbour boards, sanitary boards, poor relief authorities and others) are immense; and these amounts are not included in the central Government's financial statements, except in the case of certain "Government Contributions" from central revenues towards local expenditure.) These contributions amounted in the year 1905-6 (the latest year for which complete information is given in the Statistical Abstract) to twenty-three and a half millions out of an aggregate local expenditure of over 162 millions,—figures which should be set alongside the central Government's total revenue

and expenditure, of $136\frac{3}{4}$ and $133\frac{1}{2}$ millions, for the same year.

Compared with these figures the amounts of local revenue and expenditure in India will be found to be exceedingly small. There are certain "Provincial Rates" levied, like the English local taxes, on landed property, for expenditure on roads, schools, hospitals, famine works, etc. Their aggregate amount is about half a million pounds, and this amount appears in the statement of the central Government's accounts.

The Provincial Governments pay their way by having assigned to them, for a number of years in advance, a fixed share of the revenue collected by them under certain heads (the chief being the Land Revenue, Irrigation, Stamps, Excise, Assessed Taxes and Forests). Thus, out of a net expenditure for the year 1908-9 of £49,437,882, £29,706,031 was controlled by the Imperial Government and £19,731,851 by the Provincial Governments. The Provincial Governments, however, control areas so large, inhabited by populations so mixed, and swayed by interests so numerous and diverse, that they resemble rather the

Governments of minor States than local administrative bodies of the ordinary Western type. We may take as an instance the unwieldy province of Bengal, which, prior to its partition, had a population much greater than that of any single European State with the sole exception of Russia, while the interests of the various sections of its inhabitants were little nearer to being harmonious than are the interests of Finland with those of the other districts of the Russian Empire. In Western countries the attempt to make the minor units of government as compact and homogeneous in character as possible, with a view to the greatest administrative efficiency, necessitates in the same way frequent changes of local boundary lines.

§ 35. Besides the Provincial Governments there are three classes of local financial authorities—municipalities, district and local boards, and port trusts. The funds of all these are now treated independently of the general provincial accounts.

The Port Trusts are five in number—Calcutta, Bombay, Madras, Karachi, Rangoon and Chittagong. Their financial operations

are to be compared rather with those of State railways than ordinary governmental bodies ; for (they derive their revenues from dues levied on shipping and goods, and fees charged for services rendered ; their expenditure is concerned with harbour improvements, the erection of warehouses, jetties, harbour lights and docks.) Like most railways, they have considerable debts (over 12 millions), the interest on which is met out of their ordinary revenues. Their aggregate expenditure (1908-9) is about $1\frac{3}{4}$ million pounds.

Of municipal bodies there are over 700. About half their members are elected by rate-payers and the other half appointed by the Government. Like municipal bodies in England, they are subjected to considerable central control. Without previous sanction of the Government no new taxes can be imposed, no new loans can be raised, no work costing more than a prescribed sum can be undertaken, and no serious departure from the sanctioned budget for the year can be made.

{Corresponding to the municipalities there are in the rural areas district boards to the number of nearly 200, and subordinate to these

over 500 local boards. Their members are in most provinces partly elected and partly nominated, the latter slightly preponderating (the proportion being about five to six).

The aggregate of municipal incomes is a little over four million pounds, that of the district and local boards a little over three millions. Adding to these the revenues of the Port Trusts, we get a total of nine millions, or about one-fifth of the net revenue of the central Government; but of this nine millions, about one million comes in the form of contributions from the Provincial Governments.

(Apart from these contributions and loans, the chief sources of municipal revenues are octroi duties; taxes on houses and land; water, conservancy and lighting rates; tolls on roads and ferries; taxes on animals and vehicles;) and in some parts a tax on professions and trades. The funds of district and local boards are largely derived from rates or cesses upon agricultural land, over and above the ordinary land revenue.

Octroi duties fill a large place in the revenue systems of the municipalities. In a Western country with a highly developed system of

internal trade, where the cities are set close together, each in the centre of a network of roads which it would be terribly expensive to arrange for customs officials to guard effectively, where also most towns specialise in the wholesale production of one or two groups of commodities and import what else they need from neighbouring districts, there are overwhelming objections to the use of octroi duties. In a country like the India of to-day these objections are much less cogent, but it can hardly be said that the system is the wisest or most economical one possible.) (The choice of the forms of taxation, it should be noted, rests largely with the municipalities themselves.)

CHAPTER VI

PUBLIC DEBTS

§ 36. WHEN individuals group themselves into voluntary co-operative societies of a commercial kind, they usually expect to reap two important advantages—they are able to use the larger capital that the combination gives, less wastefully and more efficiently than the co-operators can use their separate capitals in isolation, and they are better able, through their joint credit, to increase their capital by borrowing. When a Government undertakes industrial and commercial operations (building railways, producing salt, marketing opium) the nation on behalf of which it acts may be considered as forming a sort of compulsory co-operative society, and the same advantages may be expected to accrue—more extensive supplies of capital and better credit.)) The

credit of a government or a joint stock company may be roughly gauged by the rate of interest that it has to pay on borrowed capital. This, of course, does not depend on the mere magnitude of the institution or country that is seeking to borrow. Cities like Bombay borrow at lower rates, and therefore impose on their citizens lighter burdens on account of interest, than do such states as Bulgaria and Venezuela, or even Japan. Capitalists in such matters are guided, not by sentiment, but by such practical considerations as absence of war-risks, freedom from political disturbances, clearness of public accounts, honesty of administrators, and solvency of the mass of taxpayers.)

This being so, we may ask what circumstances justify a State or a municipality in issuing a loan. For if it borrows excessively it will ruin its chances of borrowing at reasonable rates.

In general there are two sets of circumstances in which it is more commendable to raise funds by borrowing than by imposing fresh taxation. (1) If a Government is about to embark on public works, such as bridge-building or canal-making, which are expected to

yield an income in tolls or other charges, or are expected to have such an effect upon local or national prosperity that the increased wealth of the people will lead automatically to an increase in tax-revenues, it would be needless and unwise to raise the whole amount required by an increase of taxation. There is need, however, for a Government in such cases to estimate the expected revenue with great caution, basing its decision on the most careful calculations. (2) If a Government is plunged into heavy unexpected expenditure, the recurrence of which is not to be regularly looked for, a loan is again justifiable, as a means of avoiding alterations in the scale of taxation of too violent a nature, and especially of avoiding an increase in such forms of inequity as are sure to be concealed even under the best framed schemes of public finance. One of the chief considerations which a Government in such a case is called upon to face is whether it will be better to bequeath to posterity a reduced inheritance and an economic organisation dislocated by disorderly taxation, or a system moving along soberly ordered lines but burdened by an annual debt charge.

A war or a famine may be taken as instances of this type of dislocation, usually justifying recourse to loans.

The Government of the United Kingdom is in debt to the stupendous amount of £750,000,000, against which it holds assets of less than £50,000,000. The total indebtedness of the Government of India is about £270,000,000, of which all, except some £37,000,000, has been incurred in connection with railways and irrigation works, which are permanent assets of a revenue-yielding kind; while the Gold Standard Reserve of over 14½ million pounds (1910) may be counted as an asset against the Ordinary Debt.) The debt of the United Kingdom has been mainly incurred in connection with great wars (especially the French wars of 1793–1815, and the war in South Africa, 1899–1902), and the annual charges connected with this debt swallow up, roughly, one-fourth of the annual tax-revenue. The Indian debt falls into the two divisions—(1) Ordinary Debt, (2) Public Works Debt. The Ordinary Debt involves an annual charge of less than 1½ million pounds, or less than one-thirtieth of the annual net revenue. The interest

on the Public Works debt is mainly met by the revenue derived from the works themselves. Usually there is a surplus yield from these works, which means that there is a slight diminution of the total tax burden; rarely (twice only in the eleven years 1898-1908) is there a deficit involving a small addition to the public burdens.

Public opinion in the United Kingdom is averse to the idea of the Government undertaking commercially profitable public works, it being generally assumed that if really likely to be profitable they will be better left to private enterprise.¹ An exception has been made in the case of the Post and Telegraph services, in the interests of regularity and uniformity, and private companies are not allowed in this to compete against the Government. This policy is rarely criticised,

¹ Similarly there is always much unwillingness to call upon the Government to finance institutions of a philanthropic type, groups of interested people usually preferring that the economic wastage commonly associated with taxation and official administration should be avoided by the substitution of direct co-operative action. These differences of public sentiment and national temperament have made it difficult in the past for British officials to satisfy completely the desires of peoples whose traditions on these points are fundamentally different.

though it penalises to some extent the dwellers in great cities who have to pay the same amounts for the carriage of a letter from one street to another as for its carriage from London to the remotest village in Canada or New Zealand; in fact it costs a Londoner twice as much to send a postcard one hundred yards as it costs a resident in Aden to send a postcard to Rangoon.

Other undertakings of a commercially profitable kind are occasionally urged on the British Government, such as State Afforestation and Nationalisation of Railways.) The former especially (since any profits obtainable could only come after many years of waiting) has a good deal to be said in its favour as an object of Governmental rather than of private enterprise.

British municipalities, however, and Colonial Governments undertake commercial works on an ever-increasing scale. Local authorities in England are in consequence in debt to an aggregate amount of about £600,000,000. The total indebtedness of Indian municipalities and Port Trusts would seem to be about £20,000,000.

CHAPTER VII

SOME COMPARISONS

§37. The following table gives the average amounts annually raised by the Government of the United Kingdom during the four years 1905-1909 under each of the main heads of revenue, and the percentage which each part forms of the whole. For purposes of comparison between the systems adopted in a rich and in a poor country the percentages are obviously of more significance than the amounts raised.

	£	%
Customs	32,367,000	23·8
Excise	35,169,000	25·9
Death Duties	18,463,000	13·6
Stamp Duties	7,967,000	5·9
Land Tax	722,000	·5
Inhabited House Duty	1,925,000	1·4
Income Tax	32,315,000	23·8
Post Office and Telegraphs	5,235,000	4·0
Crown Lands	512,000	·4
Suez Canal Shares	1,073,000	·8
	<hr/> £135,748,000	<hr/> 100%

Over against these may be set the corresponding figures giving average amounts and average percentages of total net revenue raised annually by the Government of India for the four years 1904-1908.

	£	/
<u>Land Revenue</u>	18,338,000	38·5
Forest	1,716,000	3·6
Tributes from Native States	402,000	·8
Opium	3,738,000	7·8
Salt	4,092,000	8·6
Stamp Duties	3,943,000	8·3
Excise	5,729,000	12·0
<u>Provincial Rates</u>	757,000	1·6
Customs	4,413,000	9·3
Income Tax	1,372,000	2·9
Registration	373,000	·8
Commercial Undertakings	2,448,000	5·1
Mint	205,000	·4
Exchange	105,000	·2
	<u>£47,631,000</u>	<u>100·7</u>

In utilising these tables, however, it must be remembered that the classification adopted is one made for administrative rather than theoretical purposes, and in some cases seems to be based chiefly on the consideration whether one or another set of officials is concerned with the collection of the revenues. Thus the salt revenue is partly customs, partly excise, and partly the profits of a commercial undertaking; while the forest

revenue might also be classed, for our purposes, under commercial undertakings.

(Putting together the excise, the customs and the salt revenue, we get a total of about 30%, showing the proportion of the net revenue due to commodity taxes; as against 50% in the case of the United Kingdom. Adding the forest revenue and the opium, to the other commercial undertakings (with which, perhaps, one might also include the profits from Exchange and from the mint, and the tributes¹ from Native States) we get a total of $16\frac{1}{2}\%$ (or $17\frac{1}{2}\%$), as against 5% in the case of the United Kingdom. Similarly stamp duties yield 8·3% in the case of India, and 5·9% in the case of the United Kingdom.

The percentages, however, must not be treated as more than rough indications for comparative purposes. For though certain charges are deducted from gross revenue in order to arrive at net revenue, there still remains, on the expenditure side of the balance sheet, a heavy item—"Collection of Revenue"—which cannot apparently be so definitely allocated.

• ¹ These are chiefly paid for the maintenance of troops locally required.

It must be remembered also that the percentages illustrate primarily the differences of system adopted by the two Governments, not the relative burdens¹ borne by the two peoples. For a vast deal of governmental work which in India would be undertaken by the national Government, falls in England to the Local authorities; and (in order to arrive at the relative burdens borne, it is necessary not only to deduct, in the case of India, the profits from commercial undertakings, but to add, especially in the case of England, the great amounts raised by local taxation.) (See preceding chapter.)

§38. The chief heads of expenditure with average annual amounts and percentages for the same four years 1904-8 are given in the following table.

	£	%
Debt Services	770,000	1·7
National Defence	19,948,000	43·4
Collection of Revenue	5,456,000	11·9
Civil Services	18,713,000	40·7
Famine Relief	1,077,000	2·3
	45,964,000	100%
Reduced by Expenditure {		
from Provincial Balances {	184,000	
	£45,780,000	

¹ As illustrative of this point see the remarks on the military burdens of England and India, pp. 5, 6, *supra*.

The corresponding figures for the United Kingdom are subjoined; but they have little value for comparative purposes.

	£	/
Debt Services	31,133,000	23·4
National Defence	59,628,000	44·8
Civil Services	39,206,000	29·4
Customs and Inland Revenue Services)	3,160,000	2·4
	<hr/> £133,127,000	<hr/> 100%

§39. The above statement of net annual expenditure of the Indian Government makes no distinction between the expenditure incurred in India and that incurred in England. The latter, known as the "Home Charges," amounts ordinarily to a total of eighteen or nineteen million pounds.) Of this more than half consists of interest payments. Next in importance come pensions to former military and civil officers, amounting to three or four millions. Then there are military payments amounting to another two millions. After these comes expenditure on stores of various kinds (military stores, stationery, etc.). And finally there is the upkeep of the Secretary of State's establishment, postage, telegrams, etc., and various charges on account of

Departments in India, amounting in all to about a quarter of a million.

These payments constitute the chief part of what is often described as the economic "drain" on India, their presence being the chief factor in causing the excess of exports over imports,¹ which amounts ordinarily to some twenty million pounds. This "drain" is often spoken of as if it were something distinctive which marked India out as a tribute-paying State. But so far from this being the case, we find that the foreign trade of any economically undeveloped country, whether its people be rich and prosperous like those of Canada and Australia, or backward and poverty-stricken like those of India and Japan, is marked by the same feature. Canada and Australia, like India, borrow in England the capital they need for their development, and in consequence pay interest in England.) Their Governments, like the Indian Government, incur expenditure for governmental work done in England (*e.g.* the

¹ Owing to complicating factors, such as the investment of fresh English capital in India, it is of course not possible to correlate the figures precisely.

upkeep of the offices of high commissioners and agents-general). Their Governments and traders, like the Government of India and Indian traders, have services performed for them by English shipping and banking companies, and these services must be paid for in England. Consequently the trade of Canada and Australia shows a similar recurrent excess of exports over imports. Indeed, Australia, until three or four years ago, exported twice as much as she imported; the excess being over thirty millions. The interest payments have obviously nothing peculiar about them. For all countries are eager to borrow capital for self-development (just as a prosperous merchant or manufacturer is always glad to borrow of bankers in order to expand his operations), and capital can scarcely be borrowed unless interest is paid. The main difference, therefore, between the "drain" on India and that on Australia seems to be that in the former case some eight or nine millions is the result of expenditure of a specially governmental type. Among these, the military payments loom large. But if details were available for other countries they

would probably not appear exceptional. Similar external payments have to be made by most European countries for the upkeep of coaling stations and garrisons abroad, and in England's case these payments must be exceedingly heavy. As regards pensions, all Governments have to meet similar charges. In the United States great sums are still paid out annually as pensions to people who claim to be relatives of persons who are supposed to have fought in the wars of 1861-5, 1812-14, and 1775-82. In the case of India, as in that of other carefully administered States, the pensions are, in practically all cases, only deferred part-payments of salaries for services rendered. Their amount in each case is stipulated when the contract is made by the State to engage the official. They form part of a salary which, even when so increased, is not high enough to attract an excessive number of competent candidates to undertake the required work. (But (it will be argued) the pensioners of other Governments receive their pensions and spend them on commodities *within* the borders of the State; Indian pensioners receive and spend their pensions in England) and this involves an un-

qualified loss to India. A very little consideration, however, will show that the difference is illusory. Indian pensioners are not paid with gold and silver sent from India. (India is a net *importer* of gold and silver). They are paid in England out of the proceeds of drafts on the treasury at Calcutta which are offered for sale in London by the Secretary of State. These drafts are bought by merchants who desire to import (say) cotton or wheat from India.) The difference then clearly amounts to this. If the pensioner lived in India he would, with the money he received, make numerous small purchases of commodities and services to be supplied to him by shopkeepers, coolies, and so forth, in India. If, however, he lives in England, the money received is utilised by English *importers* to make large wholesale purchases of such commodities as cotton, the price of which consists of payments made to cotton growers, carriers, clerks, and so forth. In the latter case, indeed, there would seem to be, if anything, a smaller total loss to the country, as the energies expended in retail services are more wasteful as a rule than those devoted to

wholesale production and trade. (Two other points may perhaps be urged as distinctive of Indian conditions—(1) that the people of India have no voice in the choice of their public servants, and (2) that a considerable proportion of the higher officials are not natives of the country.) In the former point, however, the position of the people of British India is in no way different from that of the subjects of Native States or of many European countries; and until, by the gradual disappearance of caste distinctions and racial animosities, more democratic arrangements become possible, no serious alteration in this matter can possibly take place: and in any case a truly “democratic” change—one that would give a voice in political matters to India’s 200,000,000 village peasants—must for a long time to come be quite unthinkable. And as regards both points the difference (if any) between India and Australia is a difference of degree and not of kind; for it is due to the relative educational backwardness, in matters of grave social importance, of both India and Australia. Australian governors are still always chosen by the Imperial

Government from among people who are not Australians, though they are paid by the people of Australia; and when Australian Governments, or Australian public institutions such as the universities, or Australian joint stock companies, need exceptionally qualified administrators, expert advisers in military, agricultural, or industrial matters, highly qualified professors, headmasters and bishops, such men are, in a very great number of cases, selected from England, the proportion (I believe—though I have no figures to go upon) being probably as great in the case of Australia as in that of India. (Whether such appointments are made by public authority or not is of little or no economic importance to the nation at large.) Whether the persons concerned decide, at the time when they retire from service, to return to England in order to enjoy in England their pensions (deferred salaries) or savings from salaries, or choose to remain abroad, has been already shown to affect merely the *relative* gains of the classes of persons interested in their expenditures and not the *total* gains of all classes together.

(Finally we come to the upkeep of the Secretary of State's department in London. This, it is often urged, is a charge that should be borne by the United Kingdom in the same way that it bears the charges connected with the Colonial Office.) The two cases are however in no way parallel. The Colonial Secretary's work resembles that of the Foreign Secretary's department much more than it does the work of the India Office. It is essentially diplomatic work required in the interests of the British public. The Indian department, on the other hand, is mainly concerned with all sorts of banking and commercial activities—the management of the debt, the purchase of public stores, the sale of bills of exchange, the selection of officials.

(All such functions in the case of the colonies are performed not by the Colonial Office but by agents-general and high commissioners, who are appointed and salaried by the colonial Governments.) The Government of the United Kingdom cannot throw upon the colonies the cost of the Colonial Office, any more than it can throw on foreign States the cost of the Foreign Office ; nor, similarly, can India claim

that England should bear the expenses of the India Office, any more than Australia and Canada can claim that England should bear the expenses of their high commissionerships and agencies-general.

APPENDIX

(CURRENCY.)

By "standard" money is meant money made of a metal of which any person may take any quantity to the mints and demand that it be coined, either free of charge or for a very small charge,¹ - the consequence being that standard money fluctuates in value (that is, in purchasing power) with fluctuations in the value of the metal of which it is composed. (Such fluctuations may be due to changes on the Supply side, *e.g.*, the output of the mines, or to changes in Demand, *e.g.*, as a consequence of other States adopting the same standard metal, or of new uses for the metal, of a non-monetary kind, being discovered).

By "token" money is meant money coined in limited amounts at the discretion of the State and declared by the State to have a value greater than that of the metal of which it is composed.) The value (purchasing power) of such coins is not directly affected by fluctuations in the value of the metal used.

¹ Such a charge is usually called "seignorage."

any more than the value of currency notes is affected by changes in the value of the paper on which they are printed.

(In the United Kingdom gold coins (sovereigns and half-sovereigns) have been standard money since 1816. Silver and bronze token coins) are also issued in accordance with the changing requirements of trade and are declared "legal tender" for limited amounts; that is to say, they may, legally, be tendered in full settlement of any debts not exceeding certain specified sums.

In India the silver rupee was standard money until 1893. As, however, silver was rapidly declining in value relatively to gold, and the Indian Government had therefore the added difficulty in drawing up its annual budget, of forecasting not merely the amount of expenditure (reckoned in gold) to be incurred in England, and of expenditure (reckoned in silver) to be incurred in India, and the amount of probable revenue for the year (paid in silver), but also of forecasting changes in the relative values of gold and silver, it decided to approximate towards the gold standard. The change to the present system was carried out in two stages. The mints were "closed" to silver in 1893, that is to say, the public could no longer freely demand that their silver should be turned into coins. The consequence of this was that a

rupee, instead of being worth just as much as the silver of which it was composed, rapidly rose in value (purchasing power). For, as wealth and trade increased, there was greater demand for coins to be used in purchasing commodities and services, while there was no corresponding increase in the number of coins in use. (When the rupee, which had fallen in value from one-tenth to one-eighteenth of a sovereign, had risen again, in 1899, to one-fifteenth of that coin, the English sovereign was declared legal tender in India) and a rupee treated as equal to one-fifteenth of it. Thus the rupee is now, like the English shilling, a token coin. Owing, however, to its being (unlike the English token coins) not only legal tender in unlimited amounts, but the customary medium of exchange (either in coin or in the form of notes) for moderately large transactions—so that there must always be relatively vast amounts of the Indian token money in circulation (in addition to unknown amounts privately hoarded)—it is impossible in India to regulate as satisfactorily as in England the amounts which it is desirable to coin.¹ Thus there is always a

¹ The quantities of rupees annually issued depend mainly on the amount of the drafts that are sold in London by the Secretary of State and have to be met in cash at Calcutta; and this amount is affected irregularly by the changing requirements of trade, including the changing opportunities for the investment of English capital in India.

possibility of a slight depreciation¹ of the rupee, since its purchasing power does not respond as immediately as that of the sovereign and the shilling to the changing output of gold mines or the changing demand for gold in the arts. Still it is important to remember that its value is not directly affected by the changing output of silver mines or the changing demand for silver plate and silver ornaments.

For dates previous to 1899, it is difficult to give the equivalents of English in terms of Indian money, and *vice versa*,—a fact which (it may be mentioned) tends to obscure the evidences of India's growing prosperity. The process is now quite simple.

$$\begin{aligned}\text{£1} &= 20s. = 240d. \\ \text{£1} &= \text{Rs. } 15. = \text{as. } 240\end{aligned}$$

A million pounds = one and a half crores of rupees.

A crore of rupees = £666,666 13s. 4d.

A lakh of rupees = £6,666 13s. 4d.

The continuous small fluctuations in the

¹ There is, theoretically, the same possibility of the depreciation of the shilling in England—a result that would come about if a blundering Government were tempted to make profits by an excessive coinage of token money. This danger is only theoretical; but it has to be guarded against by the withholding from the Australasian and South African Governments of the power to coin their own token money.

"Exchange" chronicled in the financial columns of the daily papers, which declare that the rupee is worth, now a fraction more, now a fraction less, than sixteen English pence, (are not really concerned with the relative values of the sovereign and the rupee, but with the relative prices, paid in India for documents, giving purchasing power in England, and paid in England for documents giving purchasing power in India.) These fluctuations in exchange are caused mainly by the relative intensity of the demands of English and Indian importers and exporters of commodities for which payments must in some way be made. Similar fluctuations occur in the rate of exchange between England and Australia, in spite of the fact that both countries use exactly the same coins.

From the coinage of token money it is clear that the Government must always make a profit. In the case of India this profit is not treated as part of the ordinary revenue, but set aside to form what is called the "Gold Standard Reserve." A large part of this is invested in the purchase of English Government securities from which is received interest which still further augments this reserve.

This reserve stands (1910) at about $14\frac{1}{2}$ million pounds—a figure considerably lower than in immediately preceding years. In August, 1907 . . . , it was determined

to employ one-half of the profits on our rupee coinage in capital expenditure upon railways. The sum of £1,123,604 was actually diverted in this manner. But for the future, as has now been decided, the whole of our coinage profits without reservation will be paid into the gold standard reserve until such time as the gold held by us, in that reserve and in the Paper Currency Department combined, reaches the figure of 25 million pounds sterling.) The second important change concerns the form in which the gold standard reserve is held in England. For the future, instead of tying up the whole amount in investments, the Secretary of State has consented to keep one million sterling uninvested, letting out this sum in short loans or putting it into bank deposits. Of the balance, he will hold a considerable portion in high-class securities with a near date of redemption; and the remainder in consols or other approved stock. When we are next obliged to sell sterling bills on London, the Secretary of State will thus be able to meet them in the first instance from cash which is virtually at call. When this is exhausted, he can draw on his short-dated securities. . . . If the crisis still continues, it will become necessary to realise—and to realise gradually and carefully—the more permanent securities.” (Budget Speech of the Finance Member, Feb. 1910).

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